D.P.U. 93-159

Petition of the Massachusetts Municipal Wholesale Electric Company ("MMWEC") requesting approval by the Department of Public Utilities for borrowing by the issuance of bonds or other forms of indebtedness in total principal amount not exceeding $1,165,890,000,(Refunding Bonds), solely for the purpose of refunding up to an aggregate amount of $758,105,000 of outstanding Power Supply System Revenue Bonds for Nuclear Mix 1, Nuclear Project No. 3, Nuclear Project No. 4, Nuclear Project No. 5, Project No. 6, Wyman Project, Stony Brook Intermediate Project and Stony Brook Peaking Project consisting of 1977 Series A, 1977 Series B, 1992 Series A, 1992 Series B, 1992 Series C, 1992 Series D, and 1992 Series E (Refunded Bonds), including deposits required by MMWEC's General Bond Resolution in connection therewith.

APPEARANCES: Nicholas J. Scobbo, Jr. Esq.
Ferriter, Scobbo, Sikora, Singal, Caruso & Rodophele
One Beacon Street
Boston, Massachusetts 02108
FOR: MASSACHUSETTS MUNICIPAL WHOLESALE ELECTRIC COMPANY
Petitioner

I. INTRODUCTION

A. Procedural History

On August 26, 1993, the Massachusetts Municipal Wholesale Electric Company ("MMWEC" or "Company") filed with the Department of Public Utilities ("Department") a petition[1] requesting approval of borrowing by the issuance of bonds or other forms of indebtedness ("Refunding Bonds") in total principal of an amount not exceeding $1,165,890,000,[2] including a ten percent contingency, for the purpose of refunding up to an aggregate amount of $758,105,000 ("Refunded Bonds")[3] of outstanding Power Supply System Revenue Bonds described as follows: (1) Nuclear Mix No. 1 ("Mix 1"); (2) Nuclear Project No. 3 ("Project 3"); (3) Nuclear Project No. 4 ("Project 4"); (4) Nuclear Project No. 5 ("Project 5"); (5) Project No. 6 ("Project 6"); (6) the Wyman Project ("Wyman"); (7) the Stony Brook Intermediate

---

1 As originally filed, the petition sought $1,176,470,000 for the purpose of refunding $767,250,000. Subsequently, MMWEC filed corrected testimony which specified the changes made (Exh. M-1 at Preface 5-9) and noted that the only impact of the changes was numerical in nature.

2 The $1,165,890,000 of refunding authority consists of $935,890,000 of Refunding Bonds, including a possible $200 million to be issued on a variable rate debt basis (and including the ten percent contingency). If variable rate debt is approved, MMWEC may choose to secure that debt by a letter of credit, which would require the issuance of bank bonds in the amount of $230 million. $758,105,000 represents the amount to be refunded (Exh. M-1, at 9-10).

3 Refunding Bonds are debt instruments issued to retire outstanding bonds. Refunded Bonds are those instruments retired by the issuance of refunding bonds (Exh. M-1, at 17).

Project("Intermediate Project"); and (8) the Stony Brook Peaking Project ("Peaking Project ") (hereinafter collectively referred to as "the Projects"). The approved borrowing also would be used to pay issuance expenses and deposits required by MMWEC's general bond resolution ("GBR") in connection with the borrowings (Exh. M-1, at 9-13, 28-29).

The Department designated Yvette Begue as hearing officer. George Yiankos and Antonio Nobles, of the Department's Rates and Revenues Division, provided technical assistance.

Pursuant to notice duly issued, an evidentiary hearing was held at the Department's offices in Boston on October 20, 1993. No petitions for leave to intervene were filed. John D. Miller of the financial advisory firm of Public Finance Management, Inc. ("PFM") and James E. Fuller, assistant treasurer/treasury manager of MMWEC, testified in support of MMWEC's petition. MMWEC introduced one exhibit. The exhibit was the prefiled direct testimony of Mr. Miller and Mr. Fuller together with eight attachments (Exh. M-1). The Department introduced two exhibits consisting of the Company's Responses to the Department's Information Requests DPU 1-3 and 1-4, labelled, respectively, Exhibits DPU-1 and DPU-2.

B. MMWEC

MMWEC was created by Chapter 775 of the Acts of 1975 and is a public instrumentality and a political subdivision of the Commonwealth. St. 1975, c. 775, § 1 et seq.; G.L. c. 164, App. § 1-1, et seq.; Massachusetts Municipal Wholesale Electric

Company, D.P.U. 86-57, at 2 (1986). MMWEC is a public corporation formed to develop a bulk power supply program for Massachusetts municipal electric systems, with authority to acquire, construct, and finance ownership interest in electric generating units. St. 1975, c. 775, § 5; G.L. c. 164, App., § 1-5. It does so, in part, through the issuance of revenue bonds. Massachusetts Municipal Wholesale Electric Company, et al. v. Town of Danvers et al., 411 Mass. 39 (1991).

C. The Projects

While MMWEC owns undivided interests in its generating facilities assets, it sells the capacity and energy from these ownership interests to various Massachusetts municipal electric systems and out-of-state utilities through a planning and acquisition vehicle referred to as a project (Exh. M-1, at 14). The utilities execute power sales agreements ("PSAs"[4]) with MMWEC for their purchase of the capacity and energy output, if any, of a project (id.). MMWEC has eight projects through which it sells capacity and energy to 28 Massachusetts municipal electric systems and seven out-of-state utilities (id.).

---

4 The PSAs establish the portion of project capability for which each project participant contracted and set out the obligations of MMWEC and each participant. In general, the PSAs obligate the participants to pay their pro rata share of all expenses incurred by MMWEC in relation to the project, including any principal and interest obligations incurred as a result of debt issued by MMWEC to support the project. Each participant is required by the terms of the PSAs to fix electric rates sufficient to provide revenues to meet its obligations under the PSA. Massachusetts Municipal Wholesale Electric Company, D.P.U. 86-57, at 3 (1986).

Mix 1 consists of a 1.603 percent ownership interest in Millstone No. 3, a 1,150 megawatt ("MW") nuclear generating unit located in Waterford, Connecticut and a 0.163 percent ownership interest in Seabrook Unit 1, a 1,150 MW nuclear generating unit located in Seabrook, New Hampshire. MMWEC sells the capacity and energy from these ownership interests to 25 municipalities (id. at Att. 1). Project 3 consists of a 3.196 percent ownership interest in Millstone 3. MMWEC sells the capacity and energy from this ownership interest to 27 municipalities (id.). Project 4 and Project 5 consist of a 4.333 percent and 1.097 percent interest, respectively, in Seabrook Unit 1. MMWEC sells the capacity and energy from these ownership interests to 27 municipalities for Project 4 and 28 municipalities for Project 5 (id.). Project 6 consists of a 6.001 percent ownership interest in Seabrook Unit 1. MMWEC sells the capacity and energy from this ownership interest to 20 municipalities and one out-of-state participant (id.). Wyman consists of a 3.669 percent interest in the W.F. Wyman Unit 4, a 619 MW fossil fueled electric generating unit located in Yarmouth, Maine. MMWEC sells the capacity and energy from this ownership interest to 12 municipalities (id.). The Intermediate Project consists of a 90.757 percent ownership interest in a 343 MW oil and gas combined-cycle facility located in Ludlow, Massachusetts. MMWEC sells the capacity and energy from these ownership interests to 24 municipalities and six out-of-state participants (id.). The Peaking Project consists of a 100 percent ownership share in the Stony Brook Peaking Unit, a

170 MW fossil-fueled electric generating facility also located in Ludlow. MMWEC sells the energy and capacity to 22 municipalities (id.).

II. STANDARD OF REVIEW

In order for the Department to approve the issuance of bonds by MMWEC, the Department must determine that the proposed borrowing is reasonably necessary to accomplish some legitimate purpose in meeting MMWEC's service obligations, pursuant to G.L. c. 164, App., §§ 11, 17[5]. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I").[6]

G.L. c. 164, App., § 1-11, provides, in pertinent part:

> [MMWEC] may issue refunding bonds for the purpose of paying any of its bonds at maturity or upon acceleration or redemption, subject to the approval of the [D]epartment under this act.

---

[5] St. 1981, c. 105, amended St. 1975, c. 775, § 17, by adding the provision that Department approval is not required for the issuance by MMWEC of bonds with a maturity of one year or less.

[6] The court has found that the authority of the Department under G.L. c. 164, App., § 17, to determine whether a proposed issuance of bonds by MMWEC is "reasonably necessary" is of the same scope as the Department's authority in making such a determination for electric and gas companies under G.L. c. 164, § 14. Fitchburg II at 841-843. Since the "reasonably necessary" standard was not affected by the enactment of St. 1981, c. 105, we find that the Department's authority, except regarding short-term bond issuances, remains the same under St. 1981, c. 105, as it was under St. 1975, c. 775, § 17. Massachusetts Municipal Wholesale Electric Company, D.P.U. 89-230, at 10, n.4 (1992).

G.L. c. 164, App., § 1-17, provides, in pertinent part:

> [MMWEC] shall issue only such amount of bonds as the [D]epartment may from time to time vote is reasonably necessary for the proposed purpose of such issue, and such approval shall be subject to such reasonable terms and conditions as the [D]epartment may determine to be in the public interest; provided, however, that where such bonds are payable at periods of not more than one year after the date of issue, approval of such issuance by the [D]epartment shall not be required.

The courts have found that, for the purposes of G.L. c. 164, § 11 and G.L. c. 164, App., §§ 1-17, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946).

The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance and that the Department's authority to review a proposed issuance "is not limited to a 'perfunctory review.'" Fitchburg I at 678; Fitchburg II at 842, citing Lowell Gas at 52.

In cases where no issue exists about whether the management decisions regarding the requested financing were the result of a reasonable decision-making process, the Department limits its review to the question of whether proceeds from an issuance will be used for a purpose that, on its face, is reasonable. Canal Electric Company et al, D.P.U. 84-152, at 20 (1984).

III. MMWEC'S PROPOSAL

A. Introduction

The Company seeks approval to issue refunding bonds in an amount not exceeding $1,165,890,000 (including a contingency fund and issuance costs) for the purpose of refunding up to $758,105,000 in outstanding bonds. Of the $1.165 billion, $935,890,000 is for the issuance of fixed rate debt. However, the Company also seeks authority to possibly issue up to $200 million of the $935,890,000 on a variable rate debt basis. Should the Company receive authority to do so, it might need up to $230 million in additional funds in order to secure its debt, depending on the type of reimbursement agreement the Company ultimately negotiates with a bank. Thus, the $1.165 billion consists of $935,890,000 needed to issue refunding bonds and $230 million should the Company use some variable rate debt (Exh. M-1, at 9-10).

B. Fixed Rate Refunding Program

1. Description

The Company has financed its ownership interests in various generating facilities through revenue bonds issued under its General Bond Resolution ("GBR") and pursuant to c. 775 of the Acts of 1975 (Exh. M-1, at 13-14).

MMWEC has petitioned the Department for approval to borrow funds, by the issuance of fixed rate bonds or other forms of indebtedness, not to exceed a total of $935,890,000 of which: (1) $158,960,000 is for Mix 1, Project 3 and Wyman for the purpose of refunding $144,505,000 of MMWEC's Power Supply System Revenue Bonds, 1977 Series A; (2) $81,945,000 is for Project 4 for the purpose of refunding $74,495,000 of MMWEC's Power Supply System Revenue Bonds, 1977 Series B; (3) $107,130,000 is for Projects 3, 4, 5 and 6 for the purpose of refunding $84,400,000 of MMWEC's Power Supply System Revenue Bonds, 1992 Series A; (4) $359,445,000 is for Projects 3, 4, 5 and 6 for the purpose of refunding $274,700,000 of MMWEC's Power Supply System Revenue Bonds, 1992 Series B; (5) $64,215,000 is for Project 6 for the purpose of refunding $49,425,000 of MMWEC's Power Supply System Revenue Bonds, 1992 Series C; (6) $103,395,000 is for Project 6 for the purpose of refunding $82,150,000 of MMWEC's Power Supply System Revenue Bonds, 1992 Series D; and (7) $60,800,000 is for Projects 3,4, 5, 6, the Intermediate Project and the Peaking Project for purposes of refunding $48,430,000 of MMWEC's Power Supply System Revenue Bonds, 1992 Series E (id. at 11-13).

According to the Company, there are essentially two methods by which bonds could be refunded: (1) advance refunding or (2) current refunding (Exh. M-1, at 16). Under advance refunding, MMWEC would issue Refunding Bonds, the proceeds of which would be used to purchase United States Treasury obligations ("Treasury obligations"). The Treasury obligations would then be placed in an irrevocable escrow account maintained by the Company's bond fund trustee (id. at 17). After the escrow account is established, the lien of MMWEC's revenues, as created by the PSAs, would be defeased and the Refunded Bonds would no longer be considered outstanding under the GBR (id. at 17-18). Instead, the Refunded Bonds would be secured by the Treasury obligations in the escrow account (id. at 18). The interest and principal coming due on these obligations are matched to the interest and principal coming due on the Refunded Bonds prior to and at their first call date, and would be escrowed until the first date at which the Refunded Bonds may be called for redemption (id.).

Under a current refunding, MMWEC would instruct its bond fund trustee to redeem the Refunded Bonds within 30 to 90 days after MMWEC receives the proceeds from its Refunding Bonds (id. at 18). An escrow fund would be established in the same manner as for an advance refunding, but would only be in existence for the duration of the 30- to 90-day escrow period required (id. at 19).

A tender program would allow MMWEC to currently refund bonds not currently callable by the purchase of bonds in the open market. Two methods may be used: (1) in a "low-to-high" tender, MMWEC would accept the lowest bids first, moving to higher bids as more bonds were incorporated into the program; (2) in the "Dutch Auction" approach, bondholders tender their bonds at whatever price they choose and the Company then sets a uniform price which it pays to all bondholders tendering their bonds at or below the uniform price. The principal advantage of the former method is the low cost of the program and of the latter method, uniformity of price (id. at 20-21). Under the tender method, there is no need for a defeasance escrow account because the Refunded Bonds are cancelled immediately upon purchase (id. at 21). A tender would only be more economical than an advance refunding (assuming 100 percent of the Refunded Bonds were tendered) if MMWEC's outstanding securities are valued at a yield to their call date which is higher than the yield which could be obtained through the purchase of U.S. Treasury obligations for the defeasance escrow (id. at 21-22).

The 1977 Series A and B Bonds are currently callable and therefore, MMWEC expects to currently refund those bonds (id. at 16). Regarding its 1992 Series A, B, C, D and E Bonds, which are first callable on or after July 1, 2002, the Company intends to advance refund these bonds, unless a tender method is used, in which case they would be refunded on a current basis (id. at 16-18).

MMWEC has requested a ten percent contingency for refunding its 1977 Series A and B Bonds, and its 1992 Series A, B, C, D and E Bonds (id. at 29). According to the Company, a ten percent contingency would provide enough financial flexibility to allow MMWEC to obtain lower interest rates without the need for additional bonding approval from the Department (id. at 30). MMWEC also reported that under an advance refunding, the addition of a contingency increases the net present value of the savings associated with lower debt service costs (id.). The Company noted that in a current refunding, it could structure the Refunding Bonds to achieve additional savings (id.). Finally, MMWEC maintained that a contingency would permit the Company to advance refund additional Refunded Bonds, dependent on market conditions (id.).

2. Anticipated Savings

MMWEC seeks authority to issue its Refunding Bonds in order to lower its debt service payments by taking advantage of favorable market conditions. According to the Company, savings resulting from lower debt service payments would be passed on to Project participants through reduced billings under the PSAs for the Projects (id. at 13). The Company contends this would improve the creditworthiness of the Company, and ameliorate rates for Project participants and ultimately, their ratepayers (id. at 13, 15).

The Company explained that the level of the prevailing interest rates will have an impact on the amount of, and savings associated with, the refunding bonds (id. at 23). The reason offered is that in an advance refunding, the amount of bonds to be issued to refund a bond is inversely related to the prevailing yields on U.S. Treasury securities held in the defeasance escrow account. Thus, the amount of savings derived is a function of both the yield on the escrow and the prevailing tax-exempt interest rate (id.).

The Company prepared estimates of savings at three interest rates: 4.5, 5.0 and 5.5 percent (id. at Att. 7). Assuming current market rates (5.5 percent)[7], a current refunding of its 1977 Series A and Series B bonds would produce net present value savings over the current bonds of approximately $5.5 million and $1.2 million respectively, or 3.84 and 1.61 percent of the refunded bonds at par. Refunding the 1992 Series A through E bonds would produce net present value savings of less than two percent (Exh. M-1, at Att. 7).

MMWEC acknowledged previous testimony to the effect that it considered a five percent net present value savings generally to justify refunding (id. at 42). However, the Company indicated that, in light of current rates, which are at historical lows, a two to three percent net present value savings would now justify a refunding (id.). As a result of the refunding, and again assuming the lowest interest rate of 4.5 percent, the Company estimated that its annual debt service would decline by approximately $6.3 million on an aggregate average annual basis, and by $61.2 million on an aggregate net present value basis, for Mix 1, Projects 3, 4, 5, 6, Wyman, the Intermediate Project and the Peaking Project (id. at 41; see also Tr. at 46-47). At current market levels, annual debt service would decline by $2.7 million on an aggregate average annual present, and by $7.6 million on an aggregate net present value basis[8] (id. at Att. 7).

---

7 The Company asserted that current market levels are actually slightly lower than 5.5 percent, but that 5.5 percent is a reasonable proxy for illustrative purposes (Tr. at 48).

8 These figures are derived by adding together the gross savings for each of the 1977 and 1992 bond series assuming an interest rate of 5.5 percent, as set forth by the Company

The Company explained that the purpose of seeking authorization to issue refunding bonds is to place itself in the position of being able to take advantage of future favorable market fluctuations (id. at 43). The Company noted that it would not find it worthwhile to issue refunding bonds at an interest rate of more than 5.5 percent; for the Company, 5.5 percent is effectively a maximum interest rate or cap for refunding (Tr. at 38).

The Company included in its savings analysis an allowance for issuance costs based on 1.5 percent of the issue size of the Refunding Bonds (Exh. M-1, at 28). Issuance costs consist of underwriting discounts, bond counsel and other legal fees, printing expenses, consulting engineer's fees, financial advisory fees, and trustee fees (id. at 29).

C. Variable Rate Debt Refunding Program

The Company also proposed the use of variable rate debt in its refunding program (id. at 9). Specifically, MMWEC is seeking to issue approximately $200 million (of the total $935,890,000 in refunding authority sought) on a variable rate debt basis (id.). In support of this proposal, the Company contends that current interest rates are low.[9] Moreover, the average variable rate over the past ten years is five percent, compared to the weighted average interest cost of MMWEC's fixed rate debt of 6.2 percent.

---

in Exhibit M-1, Attachment 7.

9 The Company indicated that currently, one week variable rate demand obligations are yielding about 2.4 percent (Exh. M-1, at 48).

Finally, while variable rate debt has at times exceeded MMWEC's current fixed rate, the difference was of short duration (id. at 48). Overall the cost of variable rate debt has been lower than the cost of fixed-rate debt (id.). MMWEC explained that its Projects were capitalized in the 1970s and early 1980s through a strategy based on 100 percent long-term debt financing, because (1) there was no viable variable-rate market, (2) interest rates were increasing, and (3) tax laws of the period permitted unlimited arbitrage on debt-financed liquid assets, including MMWEC's revenue bonds (id. at 49). The Company contends that current market and financial conditions, such as the presence of a large, thriving tax-exempt, variable-rate debt market, changes in tax laws limiting arbitrage on debt-financed assets and the general decline in interest rates make variable-interest rates viable (id. at 49-50).

Pursuant to its GBR, MMWEC has funds and temporary investments of approximately $200,000,000, being financed at the Company's average cost of debt, 6.2 percent per annum (id. at 50-51). Approximately one half of the $200 million in liquid assets is subject to arbitrage rebate requirements ("rebatable") while the remainder is not subject to arbitrage rebate requirements ("non-rebatable") (id. at 50). The Company defines arbitrage as "... any profit resulting from investing the proceeds of a bond issue at a yield higher than the interest cost of that bond issue" (id. at 50). Under federal tax laws, rebatable arbitrage yields must be rebated to the federal government, while non-rebatable yields need not (id.). Because these assets are invested in short-term government securities currently earning approximately three percent per annum (Tr. at 32), MMWEC contends it is exposed to interest rate risk from short-term liquid assets, which is further exacerbated by the arbitrage regulations (Exh. M-1, at 49-50).

The Company indicated that the Project Participants receive the benefit of the interest earnings on the securities in which MMWEC invests its $200 million of liquid assets. However, the Project Participants also pay MMWEC's average long-term debt interest expense of approximately 6.2 percent. Therefore, to the extent the securities in which MMWEC invests its liquid assets yield less than 6.2 percent, the Project Participants are losing money through exposure to interest rate risk (id. at 51). In order to eliminate this risk, MMWEC proposes to convert the portion of its fixed-rate liabilities which equals its liquid assets (approximately $200 million) into variable rate debt (id.).

The Company contends that its proposed use of variable rate debt should be viewed in the context of asset and liability management (id. at 49). MMWEC considers itself vulnerable to variable interest rate risk in its reinvestments rather than in its debts (Tr. at 55). The purpose of introducing a limited amount of variable rate debt on the debt side is to cancel out the variable rate risk on the asset side and, ultimately, to reduce the risk to the entire program and "immunize the balance sheet" (id.). The Company considers this a kind of composite aggregate balance sheet management approach and contends it is a more conservative strategy (id. at 56).

According to MMWEC, converting about $100 million of its long-term fixed debt liabilities into variable rate debt will result in a positive differential, or spread, between the higher taxable yield on the securities in which the non-rebatable assets are invested versus the tax-exempt variable rate interest expense incurred across all interest rate scenarios (id. at 53). The Company explained that this is based on the historical relationship between short-term taxable investments and variable rate tax exempt debt (Exh. DPU-1, at 2). Current variable rate debt cost is estimated to be approximately 2.97 percent while the yield on MMWEC nonrebatable assets ranges from 3.11 percent to 3.77 percent (id.). The Company contends that this approach to interest rate risk management will mitigate interest rate exposure for MMWEC's Project Participants.

Regarding the Company's rebatable liquid assets, MMWEC indicated that to the extent the yield on these assets exceeds the arbitrage rebate level for each series of bonds subject to rebate, the Project Participants should be indifferent to this strategy since under arbitrage rules, MMWEC would have to pay to the federal government the earnings above the rebate levels set by the federal government (id. at 54).

However, to the extent the yield on the rebatable assets is below the rebate levels, as is currently the case, the Project

Participants are subject to interest rate risk and lose money. Therefore, the Company proposes to convert an additional $100 million of its long-term fixed debt liabilities to variable rate debt, in conjunction with the purchase of an interest rate cap to shelter the Project Participants from an increase in the variable rate debt above the rebate levels on the rebatable liquid assets. An interest rate cap is an agreement allowing the buyer the right to reimbursement from the seller in an amount equal to the difference between the actual level of floating interest rates and the cap level determined at the time of the agreement (id. at 55). The interest rate cap applies only to the rebatable liquid assets.

MMWEC has previously sought, and received, authority to assume variable rate debt. Massachusetts Municipal Wholesale Electric Company, D.P.U. 92-235 (1993). In that same Order, MMWEC was also directed to provide a maximum variable interest rate with supporting analysis the next time it sought approval for the use of variable interest rates. Id. at 11, n.5.

The Company contends that a maximum variable rate is not necessary because, based on its proposed variable rate program, the risk associated with issuing variable rate debt is reduced in two ways (Tr. at 58-60; Exh. M-1, at 55-56). First, with respect to the non-rebatable portion, MMWEC will lock in a positive spread between the yield on the non-rebatable liquid assets and the variable rate debt interest costs (Exh. M-1, at 55; Exh. DPU-1). Second, with respect to the rebatable portion, MMWEC will have the same hedge up to the rebate level for the rebatable portion, and to the extent that the interest rate on the variable rate debt exceeds those levels, MMWEC would use an interest rate cap as described above (Exh. M-1, at 55-56; Exh. DPU-2). Therefore, the interest rate exposure of Project Participants is mitigated.

Assuming MMWEC issues variable rate debt, it would need to negotiate a reimbursement obligation with a bank in order to insure payment of tendered bonds in the event of a failed remarketing (Exh. M-1, at 60). The reimbursement obligation would likely involve one of two scenarios. The first is a standby bond purchase agreement (id. at 62). A standby purchase bond agreement requires the bank to "buy" any bonds that are not remarketed. The bank keeps the bonds it has purchased and receives Company payments of principal and interest.

The second, and more likely scenario, involves a letter of credit. A letter of credit would require that MMWEC issue a "bank bond"[10] in the amount of the letter of credit, bearing a higher interest rate (id. at 62-63). The letter of credit would be for an amount equal to the total principal amount of the variable rate demand obligations issued ($200 million) plus an amount equal to 124 days, or more, of interest on the principal. MMWEC stated that the total amount will not be more than 115

---

10 The Company defines a bank bond as a reimbursement obligation between the Company and the commercial bank providing the letter of credit. In other words, it is the repayment of a loan created by the purchase of outstanding bonds by the bank (Tr. at 64).

percent of the variable rate debt to be issued by the Company (id. at 63, 65). While this plan means MMWEC must issue two separate securities, the variable rate bonds and the corresponding bank bonds, MMWEC will only be required to make payments on one set of bonds. The type of payment would depend on whether, and to what extent, MMWEC could successfully market its variable rate obligations. Should the Company decide to enter into a reimbursement agreement involving a letter of credit, MMWEC's outstanding debt would increase by $230 million ($200 million of variable rate debt times 115 percent) (id. at 64-65). However, according to the Company, the letter of credit is well regarded in the market, would work well with the legal constraints of MMWEC's GBR and would not cause market disruption in the event of a failed remarketing (id. at 61).

Since the interest rate exposure associated with the Company's rebatable and non-rebatable assets is proportionate to all Project Participants, MMWEC proposes to structure the variable rate so that each of the eight MMWEC Projects has a proportionate share of the benefits. Accordingly, the Refunding Bond authority associated with the bank bonds will be allocated among the Projects with the aim of achieving proportionality[11] (id. at 65-68).

---

11 MMWEC indicated that at this time it cannot specify the amount of bank bonds that may be allocated to each Project. Such allocations would depend on market conditions, the price of each series of bonds at the time of the refunding and the amount of liquid assets against which the variable rate debt would be matched (id. at 58, 66-67).

III. ANALYSIS AND FINDINGS

The evidence demonstrates that the proposed refunding will result in debt service savings and, in turn, savings to the Project Participants. Based on the foregoing evidence, the Department finds that MMWEC has sufficiently demonstrated that the proposed refunding will be used for a purpose that is reasonably necessary to accomplish the Company's utility operations in accordance with G.L. c. 164, App. § 1-1, et seq. and that the decision-making process underlying this proposal is based on a consideration of appropriate factors.

Issues concerning the prudence of the Company's capital financing have not been raised in this proceeding, and the Department's decision in this case does not represent a determination that any project is economically beneficial to the Company or its participants.

Regarding the Company's fixed rate financing proposal, the Department finds that such proposal is reasonable because it likely will (1) improve MMWEC's ability to borrow funds and its creditworthiness; (2) lower MMWEC's debt service payments; and (3) result in reduced billings for the Project Participants and lower electric rates for ratepayers.

The Department further finds the contingency factor used by the Company, in this case, to be prudent since this factor will allow MMWEC to respond to changing market conditions in a timely manner and to capture additional net present value savings without seeking Department approval for additional financing.

Regarding the Company's proposed use of variable rate debt in its refunding program, the Department finds that while variable interest rates entail the assumption of greater risk by the issuer, the Company has demonstrated that prevailing market conditions and financial regulations make the issuance of variable-rate debt reasonable for MMWEC and its Project participants (Exh. M-1, at 49-50). The Department further finds that the Company's use of this debt in conjunction with an interest rate cap for the rebatable liquid assets portion of the program will adequately protect Project participants from the risks associated with variable rate debt. As a result, the Department finds that the use of tax-exempt, variable rate debt likely would (1) reduce MMWEC's cost of capital; (2) facilitate a positive spread between the cost of variable rate debt and the Company's earnings capability on its liquid assets; and (3) lower the Company's fixed rate borrowing costs. The Department therefore approves the use of variable rate debt as set forth above.

IV. ORDER

Accordingly, after due notice, hearing, and consideration, the Department hereby:

VOTES: That the issuance, from time to time, by the Massachusetts Municipal Wholesale Electric Company of Refunding Bonds and temporary notes, bonds, or other evidences of indebtedness in total principal amount not exceeding $1,165, 890,000 is reasonably necessary for the proposed purpose of such issue(s); and it is

ORDERED: That the Department approves the borrowing by the Massachusetts Municipal Wholesale Electric Company, from time to time, by the issuance of Refunding Bonds (and temporary notes, bonds, or other evidences of indebtedness) in an aggregate principal amount not exceeding $1,165,890,000 to be used solely for the purpose of refunding up to an aggregate $758,105,000 of outstanding Power Supply System Revenue Bonds; and it is

FURTHER ORDERED: That the Massachusetts Municipal Wholesale Electric Company may structure the Refunding Bonds (and temporary notes, bonds, or other evidences of indebtedness) to be issued pursuant to this Order in any manner the Massachusetts Municipal Wholesale Electric Company determines to be appropriate, including the use of a variable rate debt, as long as the issuance is not otherwise inconsistent with this Order.

By Order of the Department,